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European Review



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10 April 1985

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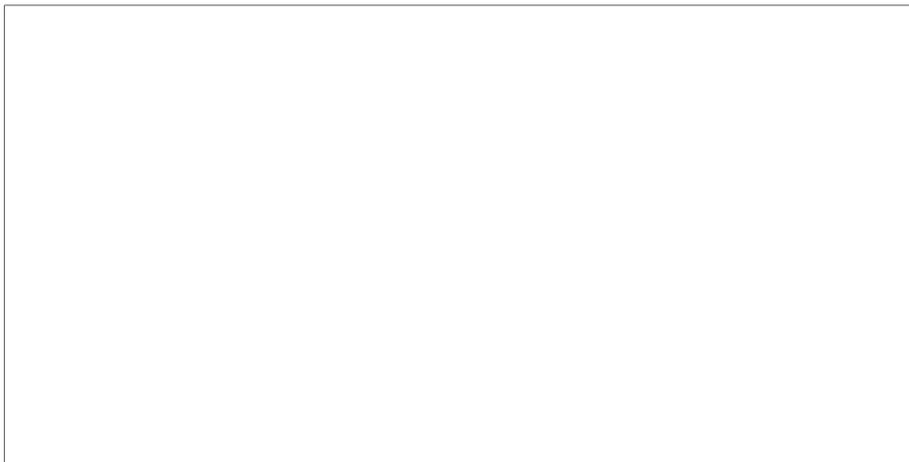
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Austria: Fallout From the Reder Affair 


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Controversy surrounding the return of a former SS officer imprisoned in Italy has raised new questions about the leadership of Chancellor Sinowatz and the viability of Austria's coalition government. The crisis has also generated doubts among foreign observers that Austria has truly come to terms with its past, an issue that may make celebrations in May marking the 30th anniversary of the State Treaty even more important to the Austrians. 

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Some articles are preliminary views of a subject or speculative, but the contents normally will be coordinated as appropriate with other offices within CIA. Occasionally an article will represent the views of a single analyst; these items will be designated as uncoordinated views. 

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Briefs**France****New Grande Ecole** [redacted] 25X1

Industry and Commerce Minister Edith Cresson recently announced the creation of a new, graduate-level school designed to train industrial managers and government officials in the skills needed to boost exports to foreign countries. The new *grande ecole*, to be known as the Ecole Nationale d'Exportation, will enroll about 200 students in courses ranging from sales techniques to foreign languages, according to Cresson. It will also reportedly offer short courses and seminars for top executives and bureaucrats. Although the school will be controlled by Cresson's ministry, it will be supervised by a national foundation composed of industrialists, university representatives, and government officials. [redacted] 25X1

A rise in exports has been one of the major achievements of President Mitterrand's economic program, and the new school is clearly intended to bolster that success. Its program will probably be oriented toward problem areas of French exports, such as the USSR and Japan, but it will almost certainly focus on expanding France's already sizable exports to the United States as well. [redacted] 25X1

Italy**Air Force Reorganization** [redacted] 25X1

The Italian Air Force is undertaking a major reorganization of its command structure, designed to streamline command and control of both combat and support units. [redacted] the number of separate organizations reporting directly to Air Force headquarters will be reduced from seven to three—for operations, schools, and support. The operational control of air units—previously the responsibility of three regional commands, each independently reporting to Air Force headquarters—will be centralized under the new operational command, with functions such as logistics and administration handled by the new support command. The reorganization is to be completed by late 1985, with personnel shifts beginning in May. [redacted] 25X1

The reorganization of the command structure is consistent with other measures taken during the past few years—such as reducing the number of Air Force bases and units—aimed at creating a more compact and cost efficient force. The new organization, particularly the formation of a separate operational command, should improve interregional operational coordination—an area of concern to Italian Air Force officers. [redacted] Overall air capabilities will remain hampered by shortages of trained pilots, spare parts, and reserve stocks—restricting the Air Force's ability to conduct sustained combat operations without substantial assistance from NATO allies. [redacted] 25X1

Spain**Basque Politicians Condemn ETA**

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ETA's assassination in early March of the chief of the Basque regional police has increased the terrorists' isolation in Euskadi. The governing Basque Nationalist Party (PNV), which had been ambivalent toward the terrorists, has condemned this latest assassination as a direct attack on itself. Previously, the PNV had insisted that the only solution to violence in Euskadi was for Madrid to extend greater autonomy to the region.

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On 14 March the PNV joined with the other parties participating in the regional parliament (a party closely linked to ETA boycotts of the assembly) in unanimously condemning ETA's terrorist tactics. The parliamentary resolution also declared that ETA could have no political role in the region as long as it resorted to violence—a significant shift from the PNV's position just a few months ago when the PNV favored negotiations with ETA. The tough new PNV line is the latest in a series of setbacks suffered by ETA—the emergence of a shadowy antiterrorist organization called GAL, French extraditions of a number of *etarras* from their sanctuaries north of the Pyrenees, and the increasingly evident weariness of the Basque population itself with terrorist violence. Although ETA retains considerable striking force, the downturn in its fortunes is unmistakable and will be hard to reverse.

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Denmark**SDI and the Security Consensus**

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Last month the Danish parliament passed a Social Democratic resolution on the Strategic Defense Initiative (SDI) that could prevent a consensus on security issues between the conservative government and its leftwing opposition. The parliamentary action also threatens to revive the burdensome practice of "footnoting," by which Danish representatives were compelled by their parliament to register objections to certain NATO decisions, principally those on INF. Specifically, the resolution opposes Danish participation in SDI research and enjoins the Schlueter government "to work actively" for compliance with the 1972 ABM Treaty, as well as negotiations to prevent "the militarization of space."

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Because of its timing, the resolution could have consequences beyond Copenhagen's present stand on SDI. The minority government, led by Schlueter's Conservative Party, has been working with the Social Democrats to craft a consensus on security policy and to avoid acrimonious and divisive debates like those that had taken place over INF. The focus of these efforts has been the Dyvig Report, named for its author, a Permanent Secretary in the Foreign Ministry, which examined such issues as nuclear-weapons-free zones and unilateral Danish initiatives regarding the country's obligations to NATO. The study, which reaffirms Denmark's role in NATO, has been the basic text for the contending parties as they attempt to negotiate a common opposition. The SDI debate and its outcome underscore the deep divisions that remain between the government and opposition, making the prospects for a security consensus doubtful at best.

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Finland**Communists Fail To Overcome Differences**

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The Finnish Communist Party's Eurocommunist faction moved closer to a complete takeover of the party at an extraordinary congress on 23 March, but is still reluctant to expel the minority Stalinist faction. Differences between the two factions—which have plagued the party for almost two decades—grew worse in recent months as the party's Eurocommunist leadership established rival organizations in districts controlled by the Stalinists. The congress passed legislation that further diminished the role of the Stalinists who boycotted the proceedings by giving the moderate-controlled Central Committee the authority to expel district party organizations and by increasing the number of such organizations required to call an extraordinary congress beyond the number controlled by the Stalinists. The Stalinists are challenging the legality of these moves in the courts.

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Most observers believe that the Eurocommunist leadership ultimately wants either to expel the hardliners or bring them to heel, but not at the cost of jeopardizing relations with the Soviets. During the congress, party Chairman Arvo Aalto emphasized the moderates' desire for good relations with the Soviets while also stating that the Finnish Communist Party advocates socialism with a "Finnish face." Moscow long has urged both sides to reconcile their differences, and, consequently, the moderates will want the burden of any split to fall on the Stalinists.

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East Germany**Antiimmigration Propaganda**

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In early March, the party daily *Neues Deutschland* claimed in two articles that emigrants were experiencing unemployment and rejection in West Germany, and alleged that 20,000 wanted to return. The articles seem to have been triggered by earlier publicity in the West German media over the arrival of some of the East Germans who last year sought to emigrate by occupying the West German Embassy in Prague. Never before has East Germany publicly admitted that so many people have emigrated. The regime also tripped over its feet by including the names and residences of some of the allegedly disgruntled refugees, many of whom later vehemently denied any desire to return East.

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The regime's clumsy propaganda seems a lame attempt to deter more embarrassing embassy sit-ins. It also reflects official recognition that last year's "emigration wave" of 40,000 resettlers did not appreciably reduce the numbers of East Germans who want to leave. Some West German specialists estimate that around half a million East Germans have applied to emigrate. A West German survey of some of last year's emigrants suggests that it will be very difficult for East Berlin to curb the desire to emigrate, since the refugees were drawn to West Germany not only by material attractions but even more by political factors such as freedom of speech.

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Poland

New Energy Program

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Parliament recently approved a 15-year energy program that includes large investments in new mines and nuclear power plants but gives little emphasis to conservation, even though Polish industry is the most energy intensive in Europe. The plan calls for increasing hard coal production by 8 percent and soft coal by 53 percent and boosting electricity output 69 percent by the year 2000. Purchases of Soviet natural gas are expected to more than double by the year 2000, contingent upon larger Polish coke deliveries and work on the Yamburg pipeline. Crude oil imports from the Soviet Union will remain at 13 million tons at least until 1990. The government wants to supplement Soviet imports by purchasing 3 million tons annually from the West, but will be hindered by its chronic hard currency shortage.

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Increased spending on energy projects—outlays will rise by over 100 percent during 1986-90 compared to the previous five years—marks a change in investment policy, which, since the early 1980s, has favored agriculture, the consumer, and industries that export manufactured goods. Although complete investment plans for the next 15 years are not available, increased investment in the energy sector is likely to come at the expense of agriculture and some consumer sectors, particularly housing.

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Articles

United Kingdom: Reforming Local Government

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Last year Parliament authorized Whitehall to limit local government revenues and expenditures. Prime Minister Thatcher now proposes to abolish the Greater London Council (GLC) and six Metropolitan County Councils—the final stage of a two-pronged plan to reform municipal administration in Britain—but faces tough opposition. The Thatcher government is claiming that the two measures together will improve efficiency in delivery of services and will save money. Opponents, including many Tory backbenchers, however, are saying that the bill is politically motivated. Thatcher probably will get what she wants by this summer, contributing to the popular impression that she is virtually invincible.

metropolitan councils have consistently exceeded spending limits set by the central government as part of its policy for restraining government expenditures.

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The Local Government Bill, if passed, would go into effect on 1 April 1986 and would establish the boroughs and district councils as the principal tier of directly elected local government. While the councils would furnish most services, new statutory authorities, such as joint boards, would be formed for services such as police, fire, and public transportation that would continue to be provided on a wider basis.

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Metropolitan Government Is Out

The proposal to abolish the metropolitan councils is consistent with Thatcher's policy of limiting spending by all levels of government in Britain. Control of public expenditure is a major part of the Tory government's strategy for redirecting a national economy suffering from high inflation, high unemployment, declining productive capacity, and lack of international competitiveness. Local outlays are 18 percent of total public expenditures, and their reduction has been a prime government objective. Such a reduction serves not only economic goals but is also part of a broader political strategy for restructuring the "welfare state."

According to Environment Secretary Jenkin, who is overseeing Thatcher's local government reforms, abolishing the metropolitan tier would eliminate waste and provide for greater efficiency in the delivery of services. Such a structure, according to Jenkin, would also result in substantial savings—about \$110 million a year—although there would be some transitional costs, including \$44 million in severance payments in FY 1986/87.¹ Local authority manpower, moreover, would fall by 8,000. About 50 percent of the savings reportedly would apply to the London metropolitan area.

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"Rate Capping"

The Tory government is already relying on legal authority won last year to restrain local governments from overspending. Existing legislation permits the

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Thatcher wants to give power to local boroughs and districts, claiming that upper level metropolitan-wide jurisdiction has led to duplication, conflict, and confusion. Moreover, she criticizes this tier because it has sought to go beyond its mandate by delving into areas such as foreign policy. She also claims that

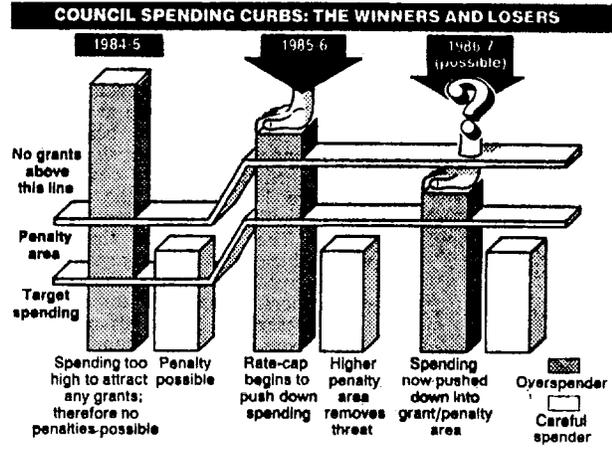
¹ In this article, pound has been converted at the rate of 1 pound = \$1.10.

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Government Grant as a Share of County Spending

Percent

	Nonmetropolitan Counties (Shires)	London	Other Metropolitan Areas
1979	53	17	30
1980	54	17	30
1981	54	16	30
1982	53	17	30
1983	53	16	31
1984	53	16	31
1985	53	15	32



The Times of London ©

central government to: (1) limit the amount of tax local jurisdictions can levy, (2) restrict expenditures to certain levels, and (3) use national grants either to reward thrifty localities or to punish overspenders. The last has been the most potent legal tool employed by the government because central government grants account for half of municipal income in the United Kingdom.

As a prelude to setting the tax rates for all local jurisdictions deemed to have overspent, Whitehall has drawn up a "hit list" of 18 localities that will have their rates "capped" this year. The 1984 Rates Act authorizes Whitehall to penalize overspenders by withholding a proportionate amount of central government grants. Because the GLC tops the list of overspenders, the abolition issue has become explicitly intertwined with "rate capping." The Thatcher government contends that the GLC and metropolitan counties together were planning to exceed the government's targets by more than \$440 million this year.

Whitehall accuses localities of spending 8.75 percent more since 1978 than would have been necessary just to keep up with price rises. For example, it pointed out that local authorities in England spent 12 percent more than the government target in the 1983/84 fiscal year—a total of \$2.8 billion. The overspending, moreover, is reportedly concentrated in precisely those localities already slated for rate capping this year.

According to the government, these jurisdictions, most under leftwing Labor control, have incurred 75 percent of the excess spending.²

Political Jockeying

Opponents of both "rate capping" and the abolition bill—the Labor Party, the Social Democratic-Liberal Alliance, and some Tory backbenchers—assert that since 1978 spending by local governments has fallen from 10.5 to 10.2 percent of the national income while the central government's current spending has increased from 27 to 29 percent. Local spending in real terms, they contend, has risen, on the average, by less than 1 percent a year. They suggest that the reason local taxes have risen is not excessive spending by local councils but the government's policy of cutting grants. In fact, while the proportion of local spending accounted for by central government grants fell from 61 percent in FY 1978/79 to 52 percent in the 1984/85 fiscal year, the absolute amounts of the grants also decreased in the same period.

Most local jurisdictions, moreover, initially claimed that the income and expenditure limits imposed by Whitehall are grossly insufficient to provide basic

² The government has also tried to hold down spending and rates in rural areas.

services. In March, officials of localities on the "hit list," particularly the Greater London Council and Liverpool, said they would defy the law by collecting higher taxes and spending more. Their threats, however, were no more than rhetoric since most of the 18 local jurisdictions slated for "rate capping," including the GLC, have agreed to comply with the law. [redacted] 25X1

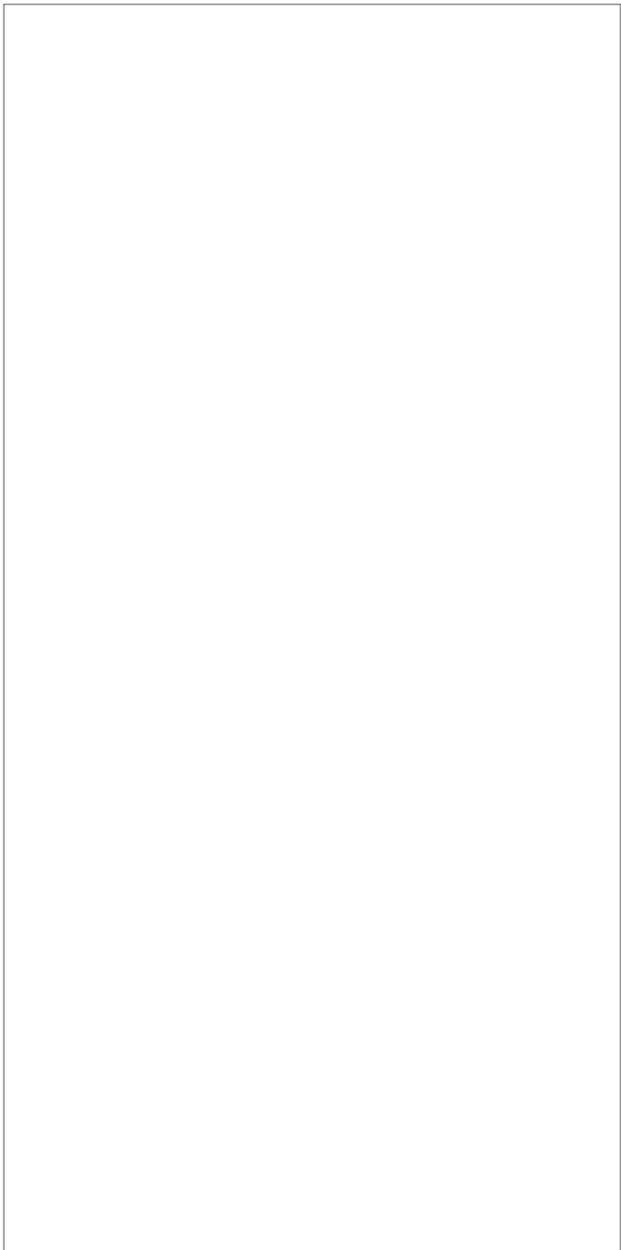
unprecedented. Many other powers, moreover, would be granted to unelected and unrepresentative joint boards. Finally, they say the bill would most likely result in cost increases to the taxpayers or reductions in services. [redacted] 25X1

The government, however, is making tactical blunders that are fueling the opposition to both "rate capping" and abolition, and the embarrassment could cost the government its proposal to abolish the councils. For example, Patrick Jenkin, the Secretary of State for the Environment, last year promised the taxpayers of a London borough that he would use the new rate-capping law to reduce their property tax by 3 percent. In early March, however, he was forced to raise the property tax rate by almost 17 percent in order to provide services at current levels. [redacted]

Opposition Tactics

Now that the House of Commons has approved the Local Government Bill, the Labor Party and Social Democratic-Liberal Alliance are concentrating on convincing the House of Lords that the bill is designed to take power away from local levels and give it to the central government. They are suggesting that the Tory government is not really interested in reducing costs but actually wants to wrest control of localities from their elected representatives (a majority of the localities are dominated by Labor) and break the back of the Labor Party at all levels of government.³ [redacted]

Opponents are also seeking the bill's defeat by focusing on those portions of the legislation that may alter the structure of government in Britain. Citing prominent Tories like former Prime Minister Heath and former Foreign Secretary Pym, they contend that the law would centralize government in the United Kingdom by giving Whitehall's ministers wide-ranging and important powers, many of them



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Thatcher's Troubles With the Falling Pound

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Prime Minister Thatcher is pleased with the pound's recent recovery after weakness in the British currency at the beginning of the year placed her in a difficult political and economic situation. Despite her efforts at that time to lay blame on external factors such as oil prices and the "unprecedented" strength of the dollar, the Labor Party charged economic mismanagement. The cost of dollar-denominated defense programs rose, and London's decision to support the pound by raising interest rates threatened to retard economic growth. Even with the pound's recovery in recent weeks, a fall in oil prices—which many oil experts expect—is likely to cause the pound to resume its slide. This would further improve British industrial competitiveness in the longer term, but, if accompanied by continuing high interest rates, it would reduce real economic growth prospects. Moreover, a repeated pound crisis might threaten the entire "Thatcher Revolution" by convincing supporters that the country is on the same "stop-go" treadmill that the Tories promised to stop. [redacted]

Exchange Rate Policy

Thatcher prefers to let the exchange markets determine the value of the pound, but, for political as much as economic reasons, she has felt compelled to act. Indeed, she painted her government into a policy corner by stating flatly that the pound should remain above parity with the dollar. [redacted]

In early January, in an effort to shore up the plummeting pound, the Bank of England supported the commercial banks when they raised the base lending rate a percentage point, and then the Bank took the initiative by boosting the rate by 1.5 percentage points a week later.¹ Renewed weakness in

¹ This is the third major occasion that the Thatcher government has boosted interest rates sharply to halt a run on the pound. After the first two instances, in October 1981 and July 1984, the pound temporarily stabilized. Most interest rates, however, came back down rather quickly, returning to precrisis levels within about six months. [redacted]

oil prices, however, caused a resumption of the slide, and on 28 January commercial banks boosted their lending rates an additional 2 percentage points to 14 percent—producing the highest real interest rates in 150 years, according to the *Financial Times*. Despite such high rates, the pound touched an all-time low of \$1.039 on 26 February. The pound has recovered lost ground recently and returned to around the \$1.20 level. With the pound exhibiting some strength, banks were able to lower their lending rates by 1.5 percentage point by 28 March with further reductions in rates possible in the coming weeks. [redacted]

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The Bank of England also has intervened in the market by selling dollars. Such intervention generally has been limited, however, and appears to have had little effect. London bankers have told our Embassy they believe there is a growing split between the Treasury and the Bank of England over the question of intervention. The Bank seemed to believe in February that more intervention was necessary but was under pressure by the Treasury to hold back. Nonetheless, the Bank apparently intervened heavily—along with a number of other central banks—on 26 February. [redacted]

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Budget Consequences

The weak pound and any further interest rate hikes could make it more difficult for the government to stay within its planned budget. Thatcher sees reduced public spending as a key to sustained economic growth, but the budget already is under pressure because of increasing outlays for unemployment compensation and the effect of the coal strike on government borrowing. Defense costs are particularly affected by the exchange rate. The pound's fall has added at least 25 percent to the estimated cost of the US-built Trident system, for example, and has forced

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the government to spread the cost over an additional five years. Higher interest rates will also increase other government expenditures. The US Embassy in London estimates that debt service would have risen this year by almost \$800 million if interest rates had remained at a 14-percent level for six months. [redacted]

The recent pound crisis forced Chancellor of the Exchequer Lawson to present a cautious FY 1985/86 budget on 19 March. The budget calls for a cut in real spending to reduce the budget deficit from \$10 billion this year to \$7.7 billion this fiscal year—which began on 1 April. The budget reflects Thatcher's goals of keeping inflation down, restoring confidence in the pound, and encouraging a fall in interest rates. Lawson offered little other than tax incentives to combat unemployment—rejecting widespread appeals to increase spending on jobs programs—in order to reduce the deficit. Lawson also reduced planned income tax cuts of \$1.5-2.0 billion to only \$825 million. [redacted]

Economic Consequences

Using our Linked Policy Impact Model (LPIM), we estimate that, had interest rates remained at the late 1984 level of 9.5 percent, the fall in the pound against the dollar from \$1.20 to \$1.12 would have a negligible impact on GNP and unemployment in 1985 and a slightly beneficial economic impact in 1986. The immediate impact would be mixed because the lower pound would raise import prices, thus reducing real consumption spending, but also would increase exports somewhat as British goods became more competitive. The longer run effect—again assuming unchanged interest rates—would be clearly positive because British consumers would over time lower spending on higher priced imports and increase spending on relatively lower priced domestically produced goods. Also, the competitive advantage reaped on the export side would boost sales abroad. [redacted]

London's efforts to halt sterling's decline by raising interest rates, however, could more than offset these potential gains. If rates stay up for more than a few months, GNP growth this year is unlikely to reach the 3.1 percent widely forecast before sterling fell below \$1.20. We estimate that, if interest rates had been

The Ups and Downs of the Pound

The pound has experienced sharp oscillations during the last decade, abetted in part by Britain's shift from being a large net oil importer to being a significant net oil exporter. After a period of relative stability in the mid-1970s, the pound began to appreciate sharply at the end of 1978 as domestic oil production rose. By first half 1981, we calculate that—on a trade-weighted and price-adjusted basis against 19 currencies—sterling had risen 43 percent above its 1975-77 average. [redacted]

In 1981 the pound reversed course, and, by the end of February 1985, its trade-weighted price-adjusted value had dropped back almost to the 1975-77 average. Most of the decline has been a correction from the previous overvaluation—which seriously eroded British international competitiveness and led to an \$18 billion deterioration in the nonoil current account balance between 1981 and 1984. The general strength of the dollar also has placed downward pressure on the pound. Between first half 1981 and 28 February 1985, the trade-weighted price-adjusted pound fell 27 percent against all currencies in our index but only 20 percent against currencies other than the dollar. In other words, the rise of the dollar accounts for almost one-third of the fall in the pound since early 1981. [redacted]

Sterling's latest episode of weakness began in mid-December. After seeming to stabilize at about \$1.20, the pound plunged nearly 8 percent in a month, reaching \$1.11 on 14 January. This decline mainly reflected pound weakness rather than dollar strength because sterling fell almost as much against other major currencies. The pound weakened primarily because of uncertainty over future oil prices and growing questions about London's resolve in fighting inflation. The coal strike also was a contributing factor—we estimate that reduced coal output and increased oil imports were costing Britain \$5 billion at an annual rate in forgone foreign exchange earnings. [redacted]

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United Kingdom: Economic Impact of a Weak Pound and High Interest Rates ^a

Percentage point change from baseline scenario

	Case I Weak Pound With Stable Interest Rates		Case II Weak Pound With Higher Interest Rates	
	1985	1986	1985	1986
Real GNP growth	-0.1	0.2	-0.6	-0.7
Of which:				
Private consumption	-1.8	-0.4	-2.9	-2.5
Government consumption	-0.1	-2.4	0.3	-1.4
Investment	-0.6	0.1	-1.8	-2.1
Exports	0.9	1.2	0.8	1.0
Imports	-2.6	-1.6	-3.8	-3.7
Unemployment rate	0	-0.1	0.1	0.2
Inflation (consumption deflator)	1.8	1.1	1.6	0.8

[redacted]. In the baseline scenario the pound and short-term interest rates are set at their late 1984 levels—\$1.20 and 9.5 percent, respectively. In case I the pound is lowered to \$1.12, with no change in interest rates. In case II the pound is kept at \$1.12, and short-term rates are raised to 14 percent.

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[redacted]

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maintained at 14 percent through 1986, GNP growth would be slower both this year and next because of sharply reduced growth of private consumption and investment. A substantial improvement in the current account probably would be insufficient to offset these negative effects on GNP. [redacted]

solve problems better left to market forces. Both Thatcher and Lawson, in answer to critics who demand greater public spending to alleviate unemployment, have claimed that market forces are ultimately the most effective means by which inefficient industries can be reformed and the economy lifted from its long malaise. Thatcher has also argued that, however painful in the short term, her policies are the only realistic way of dealing with long-term problems. The recent weakness of the pound is being portrayed by her opponents as a direct challenge to both notions. Yet failure to act if the pound falls again could revive speculation that the government does not care how fast or far sterling drops, something that Thatcher has said is not the case. [redacted]

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Political Impact of the Falling Pound

Thatcher has said that the value of a nation's currency reflects a country's basic strength, a notion her opponents are already throwing back at her. She also has often indicated that Britain's economic problems are domestically produced and must be domestically resolved, but she is frustrated by the weak pound, which she holds is at least partly due to the strong dollar and thus is beyond her control. On 31 January, the Labor Party moved to censure the government's handling of the economy, but the motion failed by a wide margin. [redacted]

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Government efforts to support sterling, especially if made for a prolonged period, run against Thatcher's conviction that the government should not attempt to

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The plight of the pound also undercuts Thatcher's claim that she is leading Britain to a painfully achieved but lasting improvement in the economy. Pound crises, and subsequent interest rate hikes and budget cuts to "restore confidence," have been an all too familiar episode in postwar British history. The current situation could persuade voters who supported Thatcher in 1979 and 1983 that, despite brave rhetoric, the country is on the same treadmill that the Tories promised to stop.

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Austria: Fallout From the Reder Affair

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Controversy surrounding the return of a former SS officer imprisoned in Italy has raised new questions about the leadership of Chancellor Sinowatz and the viability of Austria's coalition government. The crisis has also generated doubts among foreign observers that Austria has truly come to terms with its past, an issue that may make celebrations in May marking the 30th anniversary of the State Treaty even more important to the Austrians.¹

A Problem-Plagued Coalition

Austria's two-year-old government, led by the Socialist Party of Austria (SPOe) with support from the liberal Freedom Party (FPOe), has had more than its share of crises and controversies. Many Austrians have blamed Chancellor Fred Sinowatz for the problems, forgetting that two of the most difficult were inherited from the administration of the nearly legendary Bruno Kreisky. The nuclear reactor at Zwentendorf has been on the agenda since 1978 when the plant was mothballed in accordance with the result of a popular referendum, and the running feud between former Finance Ministers Hannes Androsch and Herbert Salcher over alleged financial improprieties was a product of internal party battles during the years just prior to Kreisky's retirement. Moreover, Kreisky himself has been something of an impediment. His continued criticism of Sinowatz's style and decisions has served to reinforce the popular image of the Chancellor as well meaning but ineffective.

Ironically, Sinowatz has moved decisively to solve at least these two dilemmas. He unsuccessfully attempted to call for a new popular referendum on nuclear energy, a move intended to force a decision on whether to use the Zwentendorf plant or to dismantle

¹ In 1955 Austria signed a formal peace treaty, known as the State Treaty, with the United States, the Soviet Union, France, and Great Britain ending the country's occupation. The State Treaty also reestablished Austria's complete sovereignty.

it. Sinowatz also moved to settle the Androsch-Salcher feud late last summer through a thorough Cabinet shakeup.

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The popular perception of a decisive and forceful leader was dispelled, however, by two new controversies. Last fall, the Sinowatz government appeared incapable of coping with the environmental protests blocking construction of the Hainburg dam on the Danube and was rescued only by a court order halting further work until the end of 1985. More recently, Sinowatz had to replace his Construction Minister, who resigned in January after he was linked to allegations of financial improprieties.

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The Reder Affair

The most serious threat to the government came in January when Defense Minister Friedhelm Frischenschlager, a member of the Freedom Party, personally welcomed former SS Maj. Walter Reder, who had recently been released from prison in Italy. Frischenschlager's decision provoked a storm of protest both abroad and at home, and divided the coalition. Many Socialist Party members demanded the Minister's resignation, while the Freedom Party threatened to bolt the coalition if Frischenschlager resigned. Although the government survived a no-confidence motion sponsored by the opposition People's Party (OeVP), doubts persist about the government's ability to remain in office until the next scheduled election in 1987.

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Uproar Among the Socialists

Among those demanding Frischenschlager's resignation were prominent Socialists, including some Cabinet members. One press account claimed that no

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less than five Cabinet Ministers and one state secretary had threatened to resign in protest. Although it had been rumored that a number of Socialist deputies might refuse to support the government when the no-confidence motion was called to a vote on 1 February, the motion was defeated by a vote of 98 to 80. When questioned, the disgruntled Socialist deputies argued that no purpose would have been served by bringing down their own government, whatever their feelings on the propriety of Frischenschlager's actions. [redacted]

Explanations for the Socialists' sudden unity were not difficult to find. One press report pointed to the Chancellor's threat to resign if the party refused to support the Defense Minister, a tactic that probably helped some to reassert party discipline. US officials in Vienna, however, have pointed to perhaps the most forceful reason for supporting the government: the parties' mutual fear of new elections. Polls indicate that a return to the voters now would not be likely to improve the position of either governing party; indeed, an election so soon after the ecologists' "victory" in the Hainburg controversy could well send a party of Green deputies to the national legislature for the first time. [redacted]

Doubts About the Freedom Party

Even though the coalition appears safe for the moment, the ill will generated by the Reder controversy and the questions about the reliability of the Freedom Party as a coalition partner are sure to linger. Numerous Socialists, for example, continue to question the wisdom of an alliance with the small and deeply divided Freedom Party, an opinion echoed recently in the party press. [redacted]

Such doubts are, in part, the product of the divisions separating the "liberal" and "national" wings of the Freedom Party. The FPOe acted after the war as spokesman for those Austrians who wanted to emphasize the country's German cultural heritage. This gave the party a much more nationalistic tone than usual for liberal parties on the continent, and even some former Nazis found a home in the FPOe. Over the last decade, however, the current chairman, Norbert Steger, has tried to bring the party more into

line with traditional European liberalism by emphasizing free market economic policies and the need to reduce bureaucratic controls over Austrian life. [redacted]

Steger's course has encountered resistance, however, and the Reder controversy added new fuel to the internal party debate. Joerg Haider, the maverick leader of the Carinthian provincial chapter and chief spokesman for the national wing, has used the issue to attack Steger and his liberal course; specifically, Haider has objected to Frischenschlager's apology for meeting Reder, as well as the Defense Minister's characterization of Reder as a war criminal.² At one point, Haider threatened to leave the party if the national leadership did not defend him against attacks from the Socialists for his defense of Reder. [redacted]

Although the Executive Committee disciplined Haider at its meeting in February for his attacks on the federal leadership, Haider later claimed that his "national" crusade would continue. If the Reder controversy dies, Haider, an opportunist who hopes to replace Steger as national chairman, will probably use whatever opportunity arises to attack Steger and the "liberals." In so doing, however, he will only serve to weaken the coalition by undermining his own party's credibility. [redacted]

Confronting the Past

That Reder should have been welcomed while the World Jewish Congress was meeting in Vienna underscores Austria's historical burden. Clearly aware of Israeli and Jewish sensitivities, Austrian spokesmen made two apologies: Chancellor Sinowatz spoke before the Jewish symposium in Vienna, while Frischenschlager, in an interview with an Israeli newspaper, attempted to explain away the entire affair as an unfortunate misunderstanding. Europeans, also sensitive to Austrian links to its recent past, criticized Frischenschlager's actions at a Council of Europe meeting in Strasbourg. [redacted]

² Technically, Reder's status is that of a prisoner of war. An Italian court changed the status from that of war criminal in 1980. [redacted]

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On a deeper level, the entire affair points to problems regarding the Austrian ability to come to terms with that country's part in the Third Reich. Many Austrians would like to view themselves as victims of Nazi aggression, and many historians maintain that there is some justification for this view. Few historians, however, would ignore the significant contributions made by Austrians to the Third Reich, plus the popular support for the *Anschluss*. The return of Reder has served to remind the Austrians of their painful history. [redacted]

Rather than grapple with this dilemma, Austrians probably would prefer to point to their country's positive postwar development as a member of the Western community. In particular, they are proud of Vienna's policy of "active neutrality," which has given Austria a role in world affairs out of proportion to its size. The commemoration in May of the 30th anniversary of the State Treaty, which ended the four-power occupation of Austria and set the foundations for Vienna's postwar neutrality, will give the Austrians the opportunity to put the unpleasant memories revived by the Reder controversy further behind them. [redacted]

Outlook

Although some observers have speculated that the government may call an early election, we believe the coalition more likely will "muddle through," in the words of US Embassy officials. More favorable electoral prospects would push the Socialists to appeal for a new mandate, but, as the Hainburg experience suggests, the Sinowatz government is unlikely to create such prospects through decisive actions of its own. Instead, the government probably will try to avoid contentious decisions in hopes of surviving the next two years intact. Ironically, the one casualty of the entire affair may well be Foreign Minister Gratz. He admitted publicly that he failed to instruct Frischenschlager adequately, and US officials report that Gratz's chances to succeed President Kirchsclaeger—formerly quite good—have shrunk considerably. [redacted]

The Reder affair could have unfortunate consequences for the armed forces, however. The entire affair has seriously damaged Frischenschlager's credibility and influence within the government, and his ability to strengthen and modernize the country's weak military—a goal for which he has been a forceful and active spokesman—almost certainly will be impaired. If, as some have speculated, he eventually leaves the Cabinet, the new defense minister would probably adopt a more limited agenda of defense improvements. [redacted]

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**Thoughts on Dealing
With the Belgians** [redacted]

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One Analyst's View

[redacted]

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This article does not represent a DI or CIA position; it is solely the view of the author. It has not been coordinated or reviewed. [redacted]

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The decision by the Belgian Government to deploy an initial flight of 16 cruise missiles ended what at times seemed an infinite capacity to delay acting on the issue. The INF struggle is not yet over, but the initiation of deployment permits some tentative observations on dealing with Belgium. [redacted]

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**The Primacy of Domestic Policies—
Taking Belgians With a Grain of Salt**

The overriding lesson from the long fight over INF appears to be that parochial Belgian politics almost always take precedence over foreign policy concerns, no matter how overriding they may seem to officials and analysts in Washington. At first glance, it would appear that decisionmakers in Western nations would not find it difficult to understand the primacy of domestic politics, but there is considerable evidence that this is often not the case. Officials of Western countries have been accustomed to dealing with Belgians in the context of NATO meetings or official bilateral exchanges. They were therefore usually confronted by interlocutors already committed to INF, anxious to maintain good relations with Washington, and knowledgeable about the need to balance Soviet military actions. This behavior usually masked the Belgian proclivity to act on the basis of domestic exigencies. [redacted]

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A good example came early in the INF debate. Henri Simonet, Foreign Minister in 1979 and 1980, was a leading member of the Walloon Socialist Party and a strong advocate of solidarity with NATO on INF. He repeatedly assured Belgium's allies that he would deliver a positive INF decision. Allied officials who took such words at face value were rudely awakened

when the Socialists rejected Simonet's views, driving him from both the Foreign Ministry and any active role in Belgian politics. [redacted]

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Even the most recent act in the INF drama—the effort last November by the Flemish Social Christians to postpone deployments indefinitely and Prime Minister Martens's ultimate success in keeping INF on the March schedule—found many NATO allies seemingly unaware of the linkage between the timing of the Belgian elections and the beginning of deployment. Despite rhetoric from Belgian politicians about the importance of not prejudicing arms control talks, the “crisis of nerves” during the winter had little to do with foreign policy and everything to do with fear that regional disputes might topple the coalition government and force elections too close to the initial deployment date. Allied pressure, when used at the right time, may play an important role in swaying Belgian decisionmakers, but the INF debate—and foreign policy issues in the future—ultimately turn on purely domestic factors not readily amenable to external influence. [redacted]

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**Regional Politics—Principles
and a “Cut of the Swag”**

The pervasive nature of Flemish-Walloon disputes is the dominant element in Belgian political life, a fact that surprises many outside observers. Controversial decisions have to be at least tolerable to “concurrent majorities” in the two regions. Flanders is becoming the dominant force in Belgium, both politically and economically. This development does not bode well for future support for US policies, since the role of the Catholic Church and a tradition of antimilitarism in the region have contributed to make the Flemish electorate more skeptical both of US policies and of demands that Belgium make greater defense contributions. [redacted]

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“Principled” Flemish politicians are quick, for example, to demand a part of any benefits accruing to Belgium from defense contracts. Following a decision to locate the European Repair Facility for cruise missiles in Wallonia, Flemish politicians demanded compensation. Officials are already indicating that Belgium should be exempted from certain INF-related expenses as a reward for going ahead with deployment. US-Belgian differences over technology transfer issues have also taken on a nasty “linguistic” hue, with Walloon politicians accusing Flemish leaders of bowing to US pressure to prevent a firm in the south of Belgium from exporting to the Soviet Union, thus losing “only” Walloon jobs. During a period of austerity and competition between the two regions for a “high-technology” future, opponents of US policy will increasingly try to link Washington more firmly with the regional quagmire—and argue that Belgium does not obtain sufficient economic benefits from supporting NATO on political and military issues. [redacted]

Know Your Belgians

Following the pattern in other European nations, a new generation of politicians is emerging in Belgium with little memory of the US role in the reconstruction and security of Europe after 1945 and no longer willing to leave foreign policy decisions to experts. “Old pros” like Simonet and Foreign Minister Leo Tindemans can carry forward programs like INF to a point, but the final arbiters of Belgian policies will be individuals like Social Christians Wilfried Martens and Jean-Luc Dehaine, Walloon Socialist leader Guy Spitaels, or (more worrisome) Flemish Socialist leader Karel Van Miert. These men do not have the pro-NATO credentials of a Tindemans, but instead are more in tune with the realities of Belgian domestic politics. As Belgium moves toward a federal state, regional authorities will have more say, even on matters of foreign and defense policy; US officials will thus be dealing more than ever with politicians whose horizons do not go beyond Antwerp, Liege, or the suburbs of Brussels. [redacted]

Only when Martens intervened actively late last year in the INF debate in the Social Christian Party was a decision to move ahead achieved. A key point in the future may involve Spitaels’s ability to live up to private assurances to US officials that he can induce Walloon Socialists to go along with the INF decision. In any event, the support of Belgian politicians, often unknown to NATO officials, will be essential to maintaining support for INF and keeping Brussels an active and cooperative member of the Alliance. [redacted]

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Economic News in Brief

Western Europe

West German business more confident: West German Chamber of Commerce semiannual survey of 14,000 firms found even stronger optimism than last fall . . . positive assessment strongest in export-oriented sectors . . . but still no likelihood of significant employment increases.

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Statistics on Italy's economy: Recently released government report shows more modest GDP growth and higher current account deficit than earlier estimates. . . . Real growth rebounded from -1.2 percent in 1983 to 2.6 percent in 1984, and the current account moved from a small surplus to a record trade deficit in lira terms. . . . Unemployment still over 10 percent and consumer price index up another 11 percent, after a 14.7-percent increase in 1983.

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Danish labor conflict: First major labor conflict in 12 years virtually paralyzed nation during first few days of April . . . workers protesting government-mandated strike settlement that followed breakdown of labor-management negotiations . . . settlement terms positive for economy but financial and psychological defeat for labor.

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Looking Ahead

<i>May</i> <i>Poland</i>	Underground Solidarity has called for protests on <i>May Day and Poland's Constitution Day, 3 May</i> , traditional days of protest . . . recent price increases may be incentive for wide participation, but the regime will control any violent demonstrations. <input type="text"/>	25X1
<i>Europe</i>	<i>Capitulation of Nazi Germany 40 years ago</i> will be celebrated with much fanfare by Warsaw Pact countries . . . West Germany to mark event with memorial church service and special Bundestag session . . . East Germany may accuse Bonn of regretting the defeat, but probably also will take a milder line than Moscow. <input type="text"/>	25X1
<i>Eastern Europe</i>	<i>Warsaw Pact treaty reportedly will be renewed</i> in mid-May in Warsaw in connection with celebration of 30th anniversary of Pact's formation . . . Romanians appear to have ended holdout against Soviet proposal to renew Treaty by 20 years, plus an automatic 10-year extension. <input type="text"/>	25X1
<i>June</i> <i>Czechoslovakia</i>	<i>The regime is increasing antichurch media attacks</i> to counter growing church visibility associated with observation of <i>religious event in early June</i> . . . is likely to persecute religious dissidents for participating in church-sponsored celebrations. <input type="text"/>	25X1
<i>West Germany</i>	In June Chancellor Kohl will address a group of <i>politically important expellees</i> . . . first such speech by a chancellor in more than 20 years . . . expellees from former German territories reject the finality of Germany's borders and have complicated the government's <i>Ostpolitik</i> . . . a misstep by Kohl could result in sharp domestic criticism or a renewal of Soviet charges of revanchism in West Germany. <input type="text"/>	25X1

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